

How to Determine Whether Individuals Providing Services are Employees or Independent Contractors

This overview of guidelines published by the IRS is designed to help you, as a business owner or employer, determine whether the individuals providing services are employees or independent contractors. It also provides the related IRS reporting requirements you need to consider.

Types of Business Relationships

The business relationship that exists between the employer and the worker or the person performing the services may be:

- **Independent Contractor**
- **Employee** (common-law employee)
- **Statutory Employee** (contractor per IRS common law, but treated as employee per IRS statutes)
- **Statutory Non-Employee** (direct sellers, licensed real estate agents, and certain companion sitters)

Common Law Factors that Assist in Determination

Businesses/employers must weigh the following factors when determining whether a worker is an employee or independent contractor. All information that indicates degrees of control and independence must be considered. Generally, the greater the employer controls are over the worker, the more likely the worker is an employee and not an independent contractor, regardless of the label applied in the written agreement between the parties.

| Common Law Factors | Description | Factor Questions | Control Factors |
|----------------------|---|--|--|
| Behavioral Control | Facts that indicate a right to direct or control how the worker does the work | <ul style="list-style-type: none">• Does the business control or have the right to control what the worker does and how the worker specifically does his or her job?• The more control the business exhibits, the more likely the worker is an employee. | <ul style="list-style-type: none">• When and where to do the work• What workers to hire or assist with the work• Tools or equipment to use• Where to purchase supplies and services• What work must be performed by a specified individual• Order or sequence to follow• Who provides training |
| Financial Control | Facts that indicate whether or not the business has the right to control the economic aspects of the worker's job | <ul style="list-style-type: none">• Are the business aspects of the worker's job controlled by the payer (including how worker is paid, or whether expenses are reimbursed)?• The less the financial risk of the worker, the less likely the worker is an independent contractor. | <ul style="list-style-type: none">• Extent of worker's investment• Extent of worker's unreimbursed expenses• Worker opportunity for profit or loss• Worker services available to the market or general public• Method of payment |
| Type of Relationship | Facts that define the worker and the business relationship to each other | <ul style="list-style-type: none">• Are there written contracts and/or employee type benefits included (i.e., pension plan, insurance, vacation pay, etc.)?• What is the duration of the relationship, and is the work performed a key aspect of the business? | <ul style="list-style-type: none">• Written contracts that describe relationship• Are employee benefits provided• Permanency of the relationship• Services provided are key activity of the business• Right of employer to control or direct the work |

There will not be an exact number of determining factors that will indicate whether the worker is an employee or an independent contractor, and factors that are relevant in one situation may not be relevant in another. Consider the entire relationship as a whole, consider the degree or extent of the employer's or worker's right to direct and control, and ensure that you document each of the factors used in making your determination.

Employer Compliance Obligations

Forms for Independent Contractors

- Form W-9: Have the contractor complete a W-9 form and keep for your records.
- Back-up withholding: If no W-9 form is received, you must collect back-up withholding.
- Form 1099-MISC: Most commonly used by payers to report payments made in the course of a trade or business to others for services.
- See the IRS website for 1099 reporting and W-9 instructions at www.irs.gov, as well as IRS guidance for determining independent contractors.

Consequences of Treating an Employee as an Independent Contractor

If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you may be held liable for employment taxes for that worker (the relief provisions, discussed below, will not apply). See Internal Revenue Code section 3509 for more information.

Relief Provisions

- If you have a reasonable basis for not treating a worker as an employee, you may be relieved from having to pay employment taxes for that worker. See Publication 1976, Section 530 Employment Tax Relief Requirements (PDF) for more information.

Misclassified Workers Can File Social Security Tax Form

- Workers who believe they have been improperly classified as independent contractors by an employer can use Form 8919, Uncollected Social Security and Medicare Tax on Wages to compute and report the employee's share of uncollected Social Security and Medicare taxes due on their compensation.

Voluntary Classification Settlement Program

- The Voluntary Classification Settlement Program (VCSP) is an optional program that provides taxpayers with an opportunity to reclassify their workers as employees for future tax periods for employment tax purposes with partial relief from federal employment taxes for eligible taxpayers that agree to prospectively treat their workers (or a class or group of workers) as employees.
- The IRS website has information on how to enter into this program.
- Consult your tax expert if you have questions in any of these areas.

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